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SUBJECT: MACROECONOMIC SUCCESS HAS LIMITED GRASSROOTS IMPACT

REF: ABUJA 668

**¶1.** (SBU) Summary: Nigeria's economic reform program, the National Economic Empowerment and Development Strategy (NEEDS), is only two years old, but has resulted in macroeconomic stability with the climax of a Paris Club debt write off of \$18 billion in 2005/2006. Nigeria's economic monitoring program with the International Monetary Fund (IMF) - the Policy Support Instrument (PSI) - has had positive quarterly appraisals, and foreign reserves are at an all-time high. Despite these successes, Nigerians are poorer today than they were at independence in 1960. The reforms have had only limited success in reversing years of corruption, neglect and bad management. State government is a key missing partner in reforms. Unemployment remains very high. Infrastructure is in disrepair nationwide. Outside a small prosperous group in major cities linked into the international economy, poverty seems to be on the increase particularly in the oil producing communities, culminating in hostage takings and shut downs at oil production installations and in the North, where the collapse of the textile industry and advancing desertification weighs on livelihoods. Despite robust GDP growth, its impact on reducing poverty has been far less than the headline figures would indicate. End Summary.

FEDERAL LEVEL REFORMS - MISSING STATE ACTION

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**¶2.** (U) Nigeria's medium term economic reform program, NEEDS, was launched after the 2003 general elections. The NEEDS program aims to restructure the economy, and is based on three pillars - empowering the people; promoting private enterprise; and changing the way government works. The four focal areas of NEEDS are macroeconomic reform; structural reform; institutional reforms; and public sector reforms.

**¶3.** (SBU) The state and local governments were expected to launch their own reform programs, the State Economic Empowerment and Development Strategy (SEEDS), and the Local Government Economic Empowerment and Development Strategy (LEEDS), respectively. However, because of Nigeria's federal government system, reforms by sub-national governments are purely voluntary. The hope was that success at the federal level would encourage states to follow. So far, few states and no local governments have gone forward. This is a problem because the sub-national governments control over 45% of federal revenue. The failure of states to adopt reforms greatly reduces the likelihood of combating poverty and achieving Millennium Development Goals by 2015.

REFORM ACCOMPLISHMENTS

**¶4.** (U) Nigeria's basic economic indicators have improved tremendously compared to 1999. Real GDP growth rate has averaged 6% since 2003 compared to less than 2% in 1999. External reserves which stood at \$5 billion in 1999 are now over \$40 billion, though \$12 billion was paid to the Paris Club in 2005. External debt fell from over 70% of GDP before the reforms to less than 20% in 2006. Inflation fell from nearly 25% at the beginning of 2003 to less than 15% in 2006.

**¶5.** (SBU) The Government of Nigeria (GON) adopted an oil price-based fiscal rule wherein revenue from the sale of crude oil above the budget benchmark price are set aside in a special account known as the Excess Crude Account, meant to be used to stabilize the budget in the event of future oil price fluctuations or to finance major capital investments. This should assist in avoiding the boom-bust cycle that characterized Nigeria's budget previously. Annual budgets are now drawn up in line with a medium term expenditure framework with projections for the next two years, to ensure forward financing for new projects.

**¶6.** (SBU) At the structural level, privatization of government enterprises has been slower than expected. Telecom sector liberalization has increased teledensity phenomenally. The number of active telephones was less than 1 million in 1999, and it is currently at over 20 million. Banking reforms are ongoing, while a bank consolidation exercise reduced the number of banks from 140 to 25 and raised capital requirements by the end of December 2005. Nigeria is harmonizing its tariffs with its West-African neighbors under the ECOWAS Common External Tariff (CET). Pension reforms are ongoing with the introduction of a contributory pension scheme in the public and the private sectors, while the National Health

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Insurance Scheme was introduced to cater for the health needs of the citizens.

**¶7.** (SBU) The Economic Financial Crimes Commission (EFCC) and Independent Corrupt Practices Commission (ICPC) were established to combat corruption. A few high profile arrests and investigations have been made, while some convictions have been achieved. The EFCC has seized money laundering-related assets worth over \$1.5 billion since it was established in 2003. Nonetheless, there appears to be little reduction in the level of corruption, overall. Steps have been taken to make public procurement at the federal level more open and competitive.

**¶8.** (U) Public service reforms have reduced the federal government workforce by over 30,000. Some agencies have been restructured and there is more emphasis on service delivery. Other achievements include the delisting of Nigeria from the Financial Action Task Force list of Non-Cooperating Countries and Territories in June 2006. Fitch and Standard & Poors have rewarded Nigeria's efforts with a sovereign credit rating of BB-, putting Nigeria in the same league with Turkey and Ukraine.

WHERE IS THE MIDDLE CLASS?

**¶9.** (SBU) GON representatives have claimed that there is a "burgeoning middle class", but has presented no data to support this assertion. The WB has found it difficult to find accurate data regarding wealth distribution in Nigeria, according to World Bank Senior Economist Victoria Kwa Kwa. By her estimation, the middle class is tiny and mainly made up of government civil service employees at the Director and Deputy Director level and those who contribute to the small formal private sector, centered in Lagos. There have been increases in Nigerians traveling abroad; growth in "fast food chains", domestic air travel, and cell phone use could support the contention that there is growing middle class, but could equally be attributed to changing habits of the wealthy. On the other hand there is little to indicate poverty is decreasing, but as Kwa Kwa underscored, accurate data collection is nearly impossible, making it difficult to make decisive statements. A U.S. academic, who is longtime visitor to Nigeria, said the bulk of her contacts,

who were middle class in the 1970's and 1980's, have been reduced to poverty today.

WHO IS BENEFITING FROM THE REFORMS AND OIL?

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**¶110. (U)** It remains to be seen whether the majority of the population will eventually benefit from the improved performance at the macroeconomic level. Nigeria has abundant human and natural resources but struggles with mass impoverishment. Agriculture, once its primary hard currency earner, has collapsed, and food imports now account for a sixth of the trade bill. Manufacturing is a smaller proportion of the economy - 4 per cent - than at independence, hampered by the lack of power and transport infrastructure and bad policy. The landscape is dotted with oversized industrial projects of limited utility and capacity. The collapse of the education system leaves many Nigerians unemployable and unemployment remains high amid serious shortages of skilled labor. Poverty is increasing in the oil producing communities, culminating in hostage takings and shutdowns at oil production installations. Meanwhile in the pre-dominantly Muslim North, the collapse of the textile industry and encroaching desertification is hurting the livelihoods of millions.

**¶111. (U)** According to the United Nations Development Program (UNDP), even in comparison to other African states, Nigeria lags. South Africa, the other continental heavyweight, has a GDP per capita six times greater; Angola, an oil-rich but until 2002 war-stricken country, has a GDP per capita more than 1.5 times higher; and the stable Sahelian state Senegal, with exports largely limited to groundnuts and fish, enjoys more than twice Nigeria's per capita income.

**¶112. (U)** Despite the country's oil wealth, extreme poverty - defined by the World Bank as living on less than \$1 per day - now includes 37 percent of the population. Nine out of ten Nigerians live on less than \$2 daily. Corruption, a boom and bust cycle of oil prices and the failure to diversify the economy have left the country in a development trap. Nigeria continues to produce millions of migrants, essentially economic refugees, who live throughout Africa,

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Europe and the U.S. Since 1994, when Western Union started its operations in Nigeria, an average of \$3 billion in remittances has been channeled annually via this service alone. This is twice as much as the yearly inflow of foreign direct investment (FDI) during the early 2000s.

**¶113. (SBU)** Unemployment continues to be a major problem fueling insecurity throughout the nation. Though the NEEDS program states that its major focus is job creation, jobs are not being created. Rather, jobs are being lost due to the ongoing restructuring of the civil service, other aspects of the reform, and the general harsh economic conditions. The economy's heavy dependence on the oil and gas sector, which has few linkages with the rest of the economy, tends not to create significant new employment.

INFRASTRUCTURAL WEAKNESSES

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**¶114. (SBU)** Infrastructure is in total disrepair. The roads have become death traps, while the railway no longer exists. The GON claims to have spent billions of naira on road repairs and road construction since the beginning of the present administration, but the impact of the increased allocation from the budget can neither be felt nor seen, because most major highways are filled with potholes and gullies. Traveling from the nation's commercial capital, Lagos, to the eastern part of the country is almost impossible because the roads are in terrible shape. According to the WB, it costs 320,000 naira (\$2,500) to take a 20 ton truck from the northeastern city of Maiduguri to the southwestern city of Lagos, which is more than the cost of shipping the vehicle via sea freight from Europe.

**¶115. (SBU)** Effective demand for electric power is calculated at 10,000 megawatts. Nigeria's electricity generation capacity

currently stands at about 6,500 megawatts, but actual generation is less than 3,000 megawatts. The poor state of electricity has not only increased the cost of doing business in Nigeria, but also accounts for the demise of many small businesses. The cost of running generators has risen as the GON has reduced subsidies for gasoline and other fuels. Increases in fuel prices have also led to increases in the prices of goods and services, especially foodstuff.

#### HEALTH WELFARE FALLING BEHIND

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¶16. (U) Water supply and sanitation has not improved because the GON focuses on expanding capacity without adequate plans for the sustainability of water projects. Safe water is not available in the rural areas that account for close to 70% of the population, while tap water in the urban centers is not properly treated. Though the GON launched the National Health Insurance Scheme (NHIS) in 2005, there has been no marked improvement in the provision of health services. Most hospitals lack staff, equipment and supplies, despite increased budget allocations to the sector each year.

#### COMMENT

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¶17. (SBU) Macroeconomic stability is an important and necessary condition for raising living standards, but not sufficient. The NEEDS program has achieved some major macroeconomic gains, however, it is yet to lead to a marginal improvement in the well-being of the majority of citizens. There has been growth but little development. Jobs are not being created, and the GON seems unable to tackle the problem of unemployment in the country. A missing ingredient is reform at the state and local level, which would more directly affect most Nigerians.

¶18. (SBU) With elections looming, the pace of reforms has slowed. Several important reform bills - Fiscal Responsibility, Procurement, and Nigerian Extractive Industry Transparency Initiative (NEITI) bills - are languishing in the National Assembly (NA). GON representatives have said the bills will pass before 2007. To many observers, the question of whether the current administration is focused on long-term reforms will be answered if the bills are passed before the NA becomes consumed with 2007 election machinations. Budget discipline has slipped with large and potentially inflationary spending increases approved for 2007. Good rains have led to a good harvest in Fall 2006 easing some of the immediate distress, but it is presumably a temporary reprieve.

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There have been remarkable economic improvements compared to years before the reforms, but most Nigerians may not be able or willing to wait to reap the supposed future benefits of the reforms.